ST 98-0384-GIL 12/08/1998 NEXUS

This letter discusses nexus and drop shipments. See 86 Ill. Adm. Code 150.201(i). (This is a GIL.)

December 8, 1998

Dear Mr. Xxxxx:

This letter is in response to your letter dated June 30, 1998. We regret the delay in our response. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

We are respectfully requesting technical advice in regard to sales tax in your state. Please provide guidance for the following questions.

Does a company have sales tax nexus in your state if:

1) They have sales into your state delivered solely by common carrier.

2) They have drop shipment sales with delivery and installation of equipment in your state by the equipment vendor.

3) They have sales into your state delivered solely by common carrier to a brother/sister company, who has nexus in your state.

4) They have drop shipment sales with delivery and installation of equipment in your state by the equipment vendor to a brother/sister company, who has nexus in your state and is registered for sales tax.

5) They use a contract carrier to deliver goods into your state.

Are sales transactions between brother/sister corporations viewed as being within the same entity or as separate corporations?

Does the taxable base for product sales between brother/sister corporations include inter-company profit? internal labor services? freight and installation charges?

Thank you for your assistance in answering these questions. Please return your responses to the address listed above.

NEXUS

Determinations regarding the sales tax nexus are normally very fact specific. We cannot make a binding determination on this issue in the context of a General Information Letter. However, the following discussion is helpful for businesses to use in determining their Illinois tax liability.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), copy enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, copy enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The provisions of Section 150.201(i) are subject to the U.S. Supreme Court ruling in Quill Corp. v. North Dakota, 112 S.Ct. 1904 (1992) in which the Court set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. Quill invoked a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself of the benefits of an economic market in a forum state. Quill at 1910. The second prong of the test requires that, if due process requirements have been satisfied, the person or entity must have a physical presence in the forum state to satisfy the Commerce Clause.

A physical presence does not require an office or other physical building. Under Illinois law, it also includes the presence of any representative or other agent of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the delivery and installation of the vendor's product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to Brown's Furniture, Inc. v. Zehnder, 171 Ill.2d 410 (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State.

DROP SHIPMENTS

In the classic drop shipment situation, an out-of-State seller registered with Illinois (Company A) makes a sale to another out-of-State company which is

not registered with Illinois (Company B) and drop-ships the items to "B's" customer (Company C) located in Illinois.

As an out-of-State seller required to collect the Illinois tax, "A" must either charge tax or document an exemption when it makes a delivery in Illinois. In order to document the fact that its sale to (Company B) is a sale for resale, "A" is obligated by Illinois to obtain a valid Certificate of Resale from its customer (Company B). (See 86 Ill. Adm. Code 130.1405.) Certificates of Resale must contain the following items of information:

1. a short statement from the purchaser (B) that items are being purchased for resale;

2. seller's (A's) name and address;

3. purchaser's (B's) name and address;

4. purchaser's signature and date of signing;

5. a sufficient identification of the items purchased for resale;

6. purchaser's registration number with the Illinois Department of Revenue, or

   purchaser's resale number issued by the Illinois Department of Revenue.

If Company B has no nexus whatever with Illinois, it is unlikely that "B" would be registered with Illinois. If that is the case, and if "B" has no contact with Illinois which would require it to be registered as an out-of-State Use Tax collector for Illinois, then "B" could obtain a resale number which would provide it the wherewithal to supply a required number to "A" in conjunction with a Certificate of Resale.

Resale numbers are issued to persons who make no taxable sales in Illinois but who need the wherewithal to provide suppliers with Certificates of Resale when purchasing items which will be resold. As long as "B" does not act as an Illinois retailer and, as long as it does not have nexus with Illinois, its sales to Illinois customers are not subject to Illinois Retailers' Occupation Tax liability and it cannot be required to act as a Use Tax collector. Also, as long as the above is true, "B" qualifies for a resale number which does not require the filing of tax returns with the Illinois Department of Revenue.

Please note that the fact that "B" may not be required to act as a Use Tax collector for Illinois does not relieve its Illinois purchaser of Use Tax liability. Therefore, if "B" does qualify for a resale number, "C" would have to pay its tax liability directly to the Illinois Department of Revenue.

While active registration or resale numbers on Certificates of Resale are still preferred, the Illinois Retailers' Occupation Tax Act provides (at 35 ILCS 120/2c) as follows:

"Failure to present an active registration number or resale number and a certification to the seller that a sale is for resale creates a presumption that a sale is not for resale. This presumption may be rebutted by other evidence

that all of the seller's sales are sales for resale or that a particular sale is a sale for resale."

Again, a registration or resale number from Company B on a Certificate of Resale is the preferred method for documenting that its purchase from Company A is a purchase for resale. However, in light of this statutory language, a certification from Company B on a Certificate of Resale, which described the drop-shipment transaction and the fact that it (Company B) has no contact with Illinois which would require it to be registered and that it chooses not to obtain an Illinois resale number would constitute evidence that this particular sale is a sale for resale despite the fact that no registration number or resale number is provided.

The risk run by Company A in accepting such a certification is that an Illinois auditor is more likely to go behind a Certificate of Resale that does not contain a valid resale number and require that more information be provided by Company A as evidence that the particular sale was, in fact, a sale for resale.

SUBSIDIARIES

We do not know what is meant by "brother/sister" corporations. If an out-of-State business does not otherwise have nexus with Illinois, the presence of a corporate affiliate in Illinois may or may not create nexus for the out-of-State business. Factors to consider include, but are not limited to, whether the in-State affiliate serves as a representative or agent for the out-of-State business in Illinois and whether all transactions between the out-of-State business and the in-State affiliate are conducted on an arm's length basis.

TAX BASE

Again, we do not know the nature of the sales between "brother/sister" corporations. We hope the following information regarding taxation of arm's length sales transactions will be helpful.

The Retailers' Occupation Tax Act (35 ILCS 120/1 et seq.) imposes a tax upon persons engaged in the business of selling tangible personal property at retail. The tax is based upon gross receipts from sales of tangible personal property made in the course of such business. In computing Retailers' Occupation Tax liability, 86 Ill. Adm. Code 130.410, copy enclosed, provides that, "no deductions shall be made by a taxpayer from gross receipts or selling prices on account of the cost of property sold, the cost of materials used, labor or service costs, freight or transportation costs, overhead costs, clerk hire or salesmen's commissions, interest paid by the seller, or any other expenses whatsoever.

In general, shipping and handling or delivery charges are includable in the gross receipts subject to tax unless the buyer and seller agree upon such charges separately from the selling price of the tangible personal property which is sold. In addition, such charges must be reflective of the costs of shipping and delivery. To the extent that these charges exceed the costs of shipping, they are subject to tax. See 86 Ill. Adm. Code 130.415, enclosed. As a technical proposition, handling charges represent a retailer's cost of doing business, and are consequently always includable in gross charges subject to tax. See Section 130.410. However, when such charges are stated in combination with shipping charges, they will be nontaxable to the extent the above tests are met.

The best evidence that shipping and handling or freight charges have been contracted for separately from the selling price is a separate contract for shipping and handling or freight charges. A separate listing of freight charges on an invoice, by itself, is insufficient. However, documentation that demonstrates that purchasers had the option of taking delivery of the property, at the sellers' location for the agreed purchase price, or having delivery made by the seller for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice.

Mail order delivery charges are deemed to be agreed upon separately from the selling price of the tangible personal property being sold so long as the mail order form requires a separate charge for delivery and so long as the charges designated as transportation or delivery or shipping and handling are actually reflective of the costs of such shipping, transportation or delivery. See subsection (d) of Section 130.415. If the retailer charges a customer shipping and handling or delivery charges that exceed the retailer's cost of providing the transportation or delivery the excess amount is subject to tax.

With regard to installation charges, 86 Ill. Adm. Code 130.450, copy enclosed, provides that installation charges are subject to Retailers' Occupation Tax if they are included in the selling price of the tangible personal property sold. However, if the installation charges are agreed upon separately from the selling price of the tangible personal property, they are not includable in gross receipts subject to tax.

Please note that when businesses permanently affix tangible personal property to real estate, they function as construction contractors. If this is the case, the business incurs a Use Tax liability on the cost price of the tangible personal property affixed. See 86 Ill. Adm. Code 130.1940, copy enclosed.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk
Encl.